

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

CP:E:EO:T:5

Refer Reply to:

Date:

NOV - 9 1995

Employer Identification Number:

Key District: Southeast (Baltimore, MD)

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

According to your Form 1023 Application and correspondence, you were organized on [REDACTED] as a [REDACTED] nonprofit corporation. Your purpose is to acquire and preserve historically significant wooden boats and to invite the public to experience such "floating museums."

You own the [REDACTED], a motorized commuter yacht built in [REDACTED]. Only about 50 or so commuter yachts still exist, and fewer date before World War I. Once fully restored, visitors will be welcome aboard the [REDACTED] for breakfast and afternoon tea at a fixed price of \$[REDACTED] per person. There will also be two staterooms for overnight stay at \$[REDACTED] per night. You state that the average charges for such services are \$[REDACTED] and \$[REDACTED], respectively. [REDACTED] will also be open for non-paying visitors, 11 a.m. to 4 p.m. Tuesday through Sunday. Kalmia will operate for a 180-day season, closing December through February, and available in July and August only for private charter by directors, advisors, and supporting members and for boat shows and festivals.

You plan to use your profits to maintain the [REDACTED] and purchase and operate other boats in a similar manner. You may use profits in future to develop educational programs in boat building, restoration, and seamanship.

You have three founding directors, who may by unanimous decision appoint other directors. They are [REDACTED] (Chairman), [REDACTED], and [REDACTED]. The Chairman may break deadlocks in voting. They are also three of the four officers. [REDACTED] is a professional chef and will also serve as chef on the [REDACTED]. Another officer, [REDACTED], is a professional restaurant manager. They will receive salaries

██████████ ranging from \$██████████ and \$██████████ for full-time work to \$██████████ for about 1/3rd time. Your directors also advanced you nearly ██████████ for start-up costs, including the purchase of the ██████████.

You also have a non-voting board of advisors and non-voting supporting members who pay an annual fee (\$██████████ up for individuals, \$██████████ up for corporations) and receive reduced rates for meals and lodging, access to private use of boats, a quarterly newsletter, and admission to a private New Year's Eve reception.

Until the ██████████ is restored, you will seek federal National Maritime Heritage grants and public donations for support. Once operational, you anticipate receiving visitors' meal and lodging fees and charter fees, supporting member dues, federal grants, donations, and sales of merchandise (postcards and other items). You plan to conduct semiannual campaigns to solicit donations from boat and antique enthusiasts. A sample advertisement for the ██████████ contains the following language:

m/y ██████████

You ██████████. It could be. Join us for breakfast, afternoon tea, or overnight stay and it will certainly feel that way.

We've taken care of everything aboard the Motor Yacht ██████████. She's been meticulously restored to the beauty and comfort that the Vanderbilts enjoyed on the waters of New England.

Discover the class of vessel that thrilled Ralph Pulitzer, J.P. Morgan, Edsel Ford, the Kennedys; and the class of service these great Americans and captains of industry insisted upon.

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, or certain other purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish such purposes. It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes under Section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Rev. Rul. 69-69, 1969-1 C.B. 159, held that the leasing of studio apartments and the operation of a dining hall by an exempt organization constituted unrelated trades or businesses where occupancy in the apartments was not primarily for the convenience of its members. The organization was created for the stimulation and fostering of public interest in the fine arts by promoting art exhibits, sponsoring cultural events, conducting educational programs, and disseminating information relative to the fine arts. Its activities were carried on in a building that contained offices, galleries, music rooms, a library, a dining hall, and studio apartments where artists could live and work. The studio apartments were leased only to artists, a few of whom were members of the organization. However, the apartments were not made available to the tenants on the basis of membership in the club or any criteria that would further the exempt purpose of the organization. The organization provided maid and switchboard services for the tenants similar to those provided to the occupants of rooms in hotels. The organization operated the dining hall primarily to serve the tenants of the studio apartments and only incidentally to serve its employees.

Rev. Rul. 74-399, 1974-2 C.B. 172, held that the operation of a dining room, cafeteria, and snack bar by a 501(c)(3) art museum for use by the museum staff and members of the public visiting the museum did not constitute an unrelated trade or

business activity. The patronage of the eating facilities by the general public was not directly or indirectly solicited, nor were the facilities contemplated or designed to serve as a public restaurant but merely to serve the exempt purposes of the museum. The Service reasoned that the operation of the eating facilities within the museum premises helped to attract visitors to the museum exhibits, because visitors were able to devote a greater portion of their time to the museum's exhibits than would be the case if they had to interrupt or terminate their tours of the museum to seek outside eating facilities at mealtime. The eating facilities also enhanced the efficient operation of the museum by enabling the museum staff to remain on its premises throughout the workday. Thus, the museum's operation of the eating facilities contributed importantly to the accomplishment of its exempt purposes.

Rev. Rul. 75-470, 1975-2 C.B. 207, held that a nonprofit organization formed to promote an appreciation of history through the acquisition, restoration, and preservation of homes, churches, and public buildings having special historical or architectural significance and to open the structures for viewing by the general public qualified under section 501(c)(3) of the Code. The organization consulted with governmental agencies and local historical societies to locate structures deserving of restoration and preservation. Its operations were financed from admission fees to the restored buildings, and from contributions from the public. The Service reasoned that the organization's activities were similar to a museum.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court upheld the Commissioner's denial of exemption under section 501(c)(3) of the Code to an organization formed primarily to operate vegetarian health food restaurants and stores on the ground that the organization had a substantial commercial purpose. The court considered the particular manner in which an organization's activities were conducted, the commercial hue of those activities, competition with commercial firms, and the existence and amount of annual or accumulated profits as relevant evidence in determining whether the organization had a substantial nonexempt purpose. The organization at issue competed with other restaurants, set its hours and prices competitively with area businesses using pricing formulas common in the retail food business, spent substantial sums in advertising which was commercial in style, was unable to show any donations of food to the poor, and had substantial gross profits (although no net profits) during the years at issue (its first two years).

The activity of acquiring and preserving boats of historic significance and making them available for view by the public may be educational under the proper circumstances. However, in our view, the good ship [REDACTED] looks more like a bed and breakfast inn with an old boat motif than a floating museum offering incidental room and board.

Like the situation in Rev. Rul. 69-69, your provision of room and board to guests is business which does not contribute importantly to the accomplishment of educational or other exempt purposes and therefore constitutes unrelated business. Similarly, Living Faith, Inc. indicates that an organization formed primarily to operate a restaurant is not operated exclusively for exempt purposes. As in Living Faith, Inc., your planned activities appear to be directly competitive with "bed and breakfast" inns and other commercial hotels and restaurants and will operate in a similar manner. You do not anticipate operating with substantial volunteer labor. Your officers include a professional chef and a professional restaurant manager. Your prices are competitive with area businesses. Your planned advertising appears commercial in style and highlights your provision of luxurious services. You plan to operate the room and board services at a profit, which will be used to purchase other antique boats and conduct other business in a similar fashion. While you may attract some donations and some visitors interested only in seeing the boat, it appears to us under the circumstances that you are operated primarily for the purpose of conducting a room and board business, and that the educational aspects of this business are incidental rather than predominant. We also find that a substantial part of your activities do not further exempt purposes. Therefore, you are not operated exclusively for exempt purposes.

Rev. Rul. 75-470 is distinguishable. That organization, similar to yours, acquired and restored historical buildings and held them open for view to the general public. Unlike yours however, it derived its income (aside from contributions) from admission to the buildings rather than the provision of board and private rooms within the buildings.

Rev. Rul. 74-399 is also distinguishable. In that ruling, the organization's primary purpose was to operate the art museum, not the eating facilities. The organization did not solicit the general public to patronize the eating facilities, and the facilities were not contemplated or designed to serve as a public restaurant but merely to serve the exempt purposes of the museum. The presence of the eating facility saved the time of the art

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museum visitors (who can spend hours touring such a museum) as well as staff.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
Attn: CP:E:EO:T:5 WT, Room 6539
1111 Constitution Ave, N.W.
Washington, D.C. 20224

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Technical Branch 5

initiator reviewer

CPEETS CPEETS

[REDACTED]
11/8/95

[REDACTED]
S. Chen
11/8/95

[REDACTED]
cc:

cc: DD, Southeast
Attn: EO Group

[REDACTED]:pc/CP:E:EO:T:5/10-26-95